Audit's
MONTHLY NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS
Realty Trust Review

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TRUST SHARES FOR YOUR ATTENTION

INDUSTRY TRENDS

TRUST SHARES ATTRACTING SOME UNEXPECTED BUYING GROUPS

REIT shares have been steady but not flashy performers in the post-Nixon new economic policy rally but the near-term strength has tended to obscure the longer-term performance of trust shares. For instance, our latest readings on REALTY TRUST REVIEW's two model portfolios indicate that both have outperformed the Dow-Jones Industrials by a wide margin during the choppy markets since last spring. And while 4½ months is a relatively short time to measure performance, the Paine, Webber Index indicates this performance has persisted for a much longer period.

The letters from subscribers (some questions are answered beginning on page 5) indicate that trust shares are receiving some funds from disenchanted mutual fund holders who are cashing in their fund shares to receive the much higher dividend payments from trusts. This may partly explain the fact that funds have been experiencing net redemptions since last May. Too, investors are increasingly using utility shares as their measure of comparison and there is some evidence that utility shareholders are switching into REITs because "Save A Watt" campaigns turn them off.

KENNETH D. CAMPBELL, EDITOR AND PUBLISHER / **AUDIT** INVESTMENT RESEARCH INC., 230 PARK AVENUE, SUITE 555, NEW YORK, N.Y. 10017 (212) 725-1410

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TRUST SHARES MAY CONTINUE TO BENEFIT FROM SPECIAL DIVIDEND STATUS

Trust shares have been among the market's strongest performers of late in response to the very special status trust dividends enjoy under President Nixon's appeal for voluntary restriction of dividend increases. Average price of an NYSE-listed trust share rose 5.6% in the two weeks to Sept. 3 to $29.94, vs. a 3.6% rise for the Dow-Jones Industrials.

Real estate investment trusts are not specifically exempted from the Presidential appeal, but since trusts must pay 90% of earnings to shareholders to qualify as REITs, their dividends cannot be restricted below this 90% level without risking the severe consequence of failing to qualify as a REIT.

On the surface, REITs then would be risking severe penalties if dividend declarations did not equal the 90% floor for any year. In this vein the National Association of Real Estate Investment Funds notified members immediately after President Nixon's call that, "Nothing that has been released so far which would relieve REITs of the very specific dividend payment obligations they must meet as set forth in the Internal Revenue Code." Washington sources recall that in the late 1930s President Roosevelt requested international oil companies to cease shipments of so-called "hot oil." When they complied, the Justice Dept. sued for antitrust violations and won in an historic Supreme Court decision because the Presidential appeal did not suspend existing law. (U.S. v. Socony-Vacuum Oil, 310 U.S. 150)

The REITs are in much the same status. Most do not appear disposed to risk the severe penalties of not qualifying as a REIT without some specific act of Congress or a Treasury Dept. ruling easing their rigid payout requirements. Mutual funds are also subject to similar payout requirements but since current income is a much smaller part of mutual fund return to shareholders, the dividend payment status is most important to REIT shareholders.

But REITs could comply with the President's appeal and still meet their legal requirements by resorting to year-end extra dividends. Even before the call for a freeze, some trusts such as Fidelity Mortgage were turning to a fixed quarterly rate supplemented by a year-end extra payment that satisfied the law. While this plan has the merit of simplicity, it also means that some shareholders during a trust's fiscal year might not receive 90% of earnings during any given quarter.

Within these limits, a REALTY TRUST REVIEW survey turns up the fact that some trusts have indeed increased their dividends since the freeze call, and that no trustees have been summoned to Washington to explain their actions in the same manner as have executives of six corporations. Of 15 trust dividend actions, eight have posted increases from their most recent quarters before the freeze call, while seven have declared the same dividend as before. Trustees of two of the eight trusts increasing dividends stated specifically they did not believe their action was in conflict with President Nixon's appeal. The board of trustees of MassMutual Mortgage and Realty Investors, for instance, said "it recognized President Nixon's urgings that dividends be maintained at present levels through the 90-day freeze on wages and prices. However, the Board also said it was responding to dividend obligations imposed by the Federal legislation which created real estate investment trusts." MassMutual increased its dividend from $0.33 to $0.40 per share. Old Stone Mortgage trustees also stated they did not believe their action conflicted with the President's call.

On the other hand, trustees of General Growth Properties, a development equity trust, cited the Presidential request in holding its dividend declaration to $0.23 per share, unchanged from the previous quarter.

TRUST DIVIDEND DECLARATIONS SINCE PRESIDENT NIXON'S APPEAL FOR RESTRAINT

7 Yes

Trust	Date Dec.	--------Dividends-------- Latest	Prev.	%Incr.	--Primary EPS-- Quar.	Earn.	Div. as % of earn.
Dividends increased							
Alison Mtg. Inv.	8/18	$0.57	$0.54	+ 5.6%	July	0.62	92
Diversified Mtg.	9/3	0.55	0.53	+ 7.5	June	0.60	92
First Memphis Mtg.	9/2	0.45	0.41	+ 9.8	Aug.	0.48	94
Gulf Mtg. & Rlty.	9/2	0.11M	0.10M	+10.0	May	0.21	NC
Hubbard RE Inv.	8/19	0.37	0.36	+ 2.8	July	0.40	93
MassMutual Mtg.	8/27	0.40	0.33	+21.2	July	0.49	82
Old Stone Mtg.	8/18	0.25	0.23	+ 8.7	July	0.38	66
U.S. Realty Inv.	8/18	0.40	0.375	+ 6.7	June	0.44f	91
Dividends unchanged							
Atico Mtg.	8/19	0.50	0.50	----	July	0.54	93
Conn Gen. Mtg.	9/1	0.40	0.40	----	June	0.46	87
First Mtg. Inv.	8/24	0.56	0.56	----	July	0.60	93
General Growth	9/3	0.23	0.23	----	June	0.19f	NC
Gould Inv.	9/1	0.18	0.18	----	June	0.24f	75
Lincoln Mtg. Inv.	9/3	0.20	0.20	----	June	0.20	100
MONY Mtg. Inv.	8/19	0.23	0.23	----	May	0.23	100

M-Monthly Dividend NC-Not calculated, pertinent quarter unavailable f-net cash flow

In the table, it is worth noting that most dividend declarations of trusts without increases did in fact meet the 90% requirement without increasing dividends. This was true for instance in the case of First Mortgage Investors, where the $0.56 declaration was over 90% of both the $0.60 primary and $0.57 fully diluted earnings per share. For trusts with large numbers of convertibles, dividend declarations have always posed a tricky problem since dividends are paid on shares outstanding at a specific record date following close of a quarter while earnings are reported on average shares outstanding during the quarter. In some instances, shares outstanding have been as much as 30% higher than average shares as the result of heavy conversions. With trust dividends being considered outside the Presidential freeze appeal, there is the possibility that conversions will rise so shareholders may gain the extra dividend.

In view of the run-up in trust share prices based upon their immunity to the dividend freeze, investors should move carefully at this time. We would not stress the dividend status to the exclusion of all other factors. Equally as important is an assessment of the longer-term impact of Phase II controls that will follow the wage-price-rent freeze now set to end Nov. 13. At this juncture one can only surmise about the shape and duration of controls that will emerge from the White House-Congressional debate now starting. Our reading of the Washington mood is that controls will be relaxed only gradually over the next year or so, and some idea of what substance they may take can be seen in the shape of controls already in effect.

Rent controls on a continuing basis likely will have the largest impact upon trusts. Rents are now frozen at levels for a base period of 30 days ending Aug. 14, with increases permitted only if "substantial improvements" involving expenditure of over three-months' rent are made. Vacant space cannot be increased, and never-occupied space must be rented at rates for comparable property. Rents cannot be increased even if property taxes (which are unfrozen) go up and escalator clauses based on increased costs of services will not operate during the Phase I freeze. Rent overage charges as a percentage of retail sales apparently are not affected, however.

Our best guess is that rent control will be relaxed, first to remove inequities such as rising property taxes and differentials between similar spaces in similar buildings, and second, to bring returns up to some standard floor. Later modest percentage increases might be permitted followed by removal of controls. The net effect of these rules will be 1) to lock-in ownership trusts to existing schedules with only overage rent arrangements providing some growth in revenues from existing buildings, and 2) to make new investment in buildings more attractive since rent scales can be set at competitive rates while labor and material costs remain frozen.

Interest rates, both long-term and short-term, are likely to fall modestly during the stabilization period to follow the freeze. This will occur if the freeze shows visible signs--such as a decline in the consumer price index--of slowing or halting inflation. All interest rates now carry a substantial inflation allowance and this allowance should fall if and when inflation abates. We would not rule out too the possibility that dollars now in Europe may come home as European nations cut their discount rates to ward off sizable dollar inflows. In this situation, for instance, North American Mortgage Investors has just repaid a $5 million Euro-dollar loan made at 10 3/4% in the summer of 1970, because the spread betweem medium-term U.S. and Euro-dollar rates had become so wide.

In this context we would concentrate attention upon long-term mortgage trusts which have locked in their funds at historically high rates and which appear to be in the best position to capitalize on these rates by maintaining a continuing flow of quality investments. In the short-term mortgage trust area, we would concentrate upon those trusts with proven originating and leveraging capability. Eight major long-term trusts are summarized in the table below.

yes

STATISTICS ON EIGHT MAJOR LONG-TERM TRUSTS

Trust#	----Mil. $----- Assets	Capital	Port. yield*	Quar.	---EPS--- Prim.	Dil.	Div.	Price	Est. yield	% Long Term
BankAmerica (OTC)	$ 93.92	$ 72.89	8.78%	Apr.	0.45	NA	$0.55	27.50	8.00	41.4%
ConnGen. Mtg.	211.83	192.00	10.11	June	0.50	0.46	0.40	35.38	4.53	22.6
Equitable Lf.Mtg.	145.90	144.83	10.52	July	0.46	0.44	0.42	30.63	5.48	73.8
Gulf Mtg.(ASE)	40.64	40.54	5.9i	May	0.21	0.21	0.31a	19.38	6.40	60.9
MassMutual Mtg.	98.23	96.68	8.37	July	0.49	0.42	0.40	28.88	5.54	51.9
MONY Mtg.Life Mtg.	130.52	96.03	9.25	May	0.27	0.23	0.23	13.88	6.63	27.5
NW Mut.Life Mtg.	102.01	97.16	8.09i	June	0.32	0.31	0.28	28.24	3.96	57.9
State Mut.(ASE)	59.19	58.38	8.66	June	0.33	0.33	0.31	25.13	4.93	30.0

?

#Listed on NYSE unless otherwise indicated. *Based on average portfolio in latest quarter with complete data. a-Paid monthly; amount is total paid in last three months. i-Initial quarter, may not be indicative of later results.

Funding of long-term investments, the primary focus of these trusts, has taken varying degrees of time. The table shows that the two oldest long-term trusts, Connecticut General Mortgage and Realty and MONY Mortgage Investors, have the lowest percentages of total portfolio in long-term investments. Relative newcomers like Equitable Life Mortgage and Northwestern Mutual Life have placed significantly higher percentages of assets in longer-term investments. ConnGen's funding level reflects a second round of financing in May, however.

Connecticut General Mortgage and Realty Investments, now largest of the long-term trusts, had $56 million funded long-term as of June 30 and commitments for another $105 million are due for funding over the next 24 months. Short-term commitments amount to $63 million over $118 million already funded in this category. The long-term investments and commitments had a weighted average 10.4% yield through 1970, with

commitments this year shading off from that figure. Nearly all the early commitments and most newer ones contain some form of trust participation in gross revenues of the property. The May financing was most favorable and the trust has excellent strength both in loan origination and access to additional capital. The shares are a sound long-term holding, even though present prices may have gotten a little ahead of earnings.

Equitable Life Mortgage and Realty Investors has completed full investment of proceeds from its $150 million offering last fall and now plans to begin selling small amounts of commercial paper. The trust says new construction and development loans are yielding about 9.0%, with long-term mortgages yielding about 0.5% lower. During the July quarter, new commitments averaged 8.94% for long-term loans and 9.37% for short-term and construction loans. At the end of July, $77.1 million of the $113.1 million portfolio was in long-term loans and $6.4 million in equities. Most closed loans contain some equity participations but the trust says "kickers" are becoming much less prevalent in new offerings, and most now take the form of a percentage of increases in future gross income. Trust shares traded as high as 35¼ early this year before falling to 25 3/4 in the April-July decline. They have since recovered to over 30. The estimated 5.54% yield from the shares is about 1% better than afforded by ConnGen shares and the shares too are well regarded for longer-term accounts.

MassMutual Mortgage and Realty Investors, sponsored by the 10th largest U.S. life insurance company, has been reporting gradually rising income from participations in gross income from mortgaged properties and leverage gains made through sale of commercial paper. At the end of July the trust held $110.8 million of investments carrying a 9.81% average yield. Commitments of $80.3 million carry an estimated 9.88% yield. With long-term investments of $48.0 million at the end of April, the trust was over 50% invested in long-term loans. About 38% of investments are in shopping centers and 29% in apartment buildings, with a 10% share in discount stores making up the largest remaining sector. MassMutual trustees are among those showing willingness to increase dividends commensurate with earnings growth and while earnings growth may be more difficult to achieve from here, the shares should do well long-term.

QUESTIONS OF UNIVERSAL INTEREST FROM SUBSCRIBERS ANSWERED

Q. *Colwell Mortgage Investors* (28 1/4-ASE) sells for a relatively low multiple on estimated earnings of $2.30-2.40. What is the reason?

A. Colwell's recent annualized earnings were $2.48 before dilution from a potential 100% increase in shares from warrants exercisable at $20. The 11.4 multiple is a bit low compared to the group. We believe this reflects the slow growth to date from a small base. This, however, was essentially deliberate as the adviser, Colwell Co., the large California mortgage banker, was selecting correspondents. After being almost flat from inception, commitments and assets have boomed since the March quarter going from $22 to $34 million in July. Moreover, this asset increment was financed by low-cost bank lines without compensating balances. The trust had $18 million in such lines out in July at an effective interest rate of under 6%. Current yields on its portfolio are running at 11.5%. The trust has no loans in foreclosure or default and more important, with the backing of its long standing mortgage banker, can probably perform the necessary checks and actions to prevent or work out of difficulties. Thus the adviser is showing control while not originating directly.

The trust is currently raising $15 million via convertible debentures with 300,000 warrants. The capital base is undoubtedly being increased because of the

aforementioned growth and the necessity to prepare for expected growth over the next few months. The trust probably feels it can not stretch its leverage much beyond its present small capital base of $15 million. It will therefore temporarily replace low-cost borrowings with the convertible debt and add another warrant issue. While now being in a position to leverage to perhaps a $90 million trust (3-1) it adds the dual overhang to potential share issue with the stock trading a fair 50% over book but still dragging the anchor of the old warrants. An underwriter's dream will someday become an investor's nightmare. Overall, the shares are moderately attractive intermediate term for value and an 8.2% yield.

Q. What is your evaluation of *Mortgage Trust of America* (27-NYSE)?

A. This trust's backing rests on the firm underpinning of two Transamerica subsidiaries, one an experienced real estate lender and the other a major mortgage banker. Growth has been consistent and was particularly impressive in the recent May quarter when assets were increased 16% during a slow, difficult period. Operations are in line with conventional short-term trusts but with more muscle. MTA had $31 million in commercial paper out with assets of $99 million. Additionally, shareholder approval was obtained to increase flexibility to permit longer term loans, equity investments and junior mortgages (up to 15%). Nearly half the portfolio was committed to California and apartments were the largest category with 32%. The shares offer somewhat above-average value selling at 11.8 times annualized earnings of $2.28 and yielding 8.5%. It appears the issue has fallen into a forgotten niche where the substantial sponsorship is overlooked. However, this is another issue whose earnings will have to overcome a nearly 100% share increase from warrants.

Q. Is *Lomas & Nettleton Mortgage Investors* (41 3/4-OTC) the best trust holding for me?

A. Lomas & Nettleton has one of the better records of consistent growth. This performance stems mainly from its adviser being the largest mortgage banker which originated nearly $300 million in short-terms loans alone during its past fiscal year. Combined with advantageous bank borrowings, for which the adviser often supplies balances, the trust has now leveraged its equity nearly 100%. Activity is concentrated in the Southwest but should diversify further as the adviser becomes more nationally oriented. Having no convertible or warrant issues overhang the equity base, the trust will be in good position to capitalize on future financings with its stock selling 81% over book value. The stock represents a well situated trust that is fairly valued and has strong sponsorship. It is well worth retaining even if not among the most undervalued in the group.

Q. *Arlen Realty Investors* (16 3/8-OTC) will not engage an adviser but the trustees will administer the trust. Will this be beneficial for shareholders?

A. This can be a two-edged sword. Saving the shareholder the advisory expense can be significant (RTR-July 12). The trustees, however, have very full control with the insiders having a majority and properties are being transfered from the insiders' controlled realty corporation. The trustees can therefore control the net yield to the trust and the advisory saving may not be fully passed along. The situation is very much at the discretion of the trustees.

Q. How will the President's new policy affect the formation of new trusts?

A. The freeze may further slow new trust formation. The uncertainty of rent ceilings extending over a period of time has already delayed plans for some commercial projects according to one source. In time, this should clear up and underlying real estate pressures should reassert themselves.

MODEL PORTFOLIO REVIEW: BOTH GROUPS UP SHARPLY IN MONTH

When we first initiated the REALTY TRUST REVIEW portfolios last April 21, the Dow-Jones Industrials stood at 941.33, very near their high for this year. They immediately began falling and hit bottom at 834.92 early in August. Both our model portfolios declined, although not nearly as much. The post-Nixon economic policy market has now carried the DJI back to 916.47, where it is off only 2.64% from the April level. Both RTR portfolios have now broken well above their initial capitalization of $100,000, with strong gains last month pushing both over the top. The Model II portfolio for aggressive intermediate term investors was up 10.1% for the month and now has a net asset value of $111,596 after paying all transaction charges. The Model I portfolio for long-term investors rose 8.6% this past month, its sharpest monthly gain, and now stands at $102,179.

As expected, dividends have provided a good but not dominant share of the returns from the portfolios. The Model I group has received $2,193 in dividends while the mortgage portfolio has garnered $3,686 in cash payments. Dividends have been held in the accounts or reinvested when attractive opportunities appear. Comments on portfolio issues:

B.F. Saul REIT has agreed to acquire Giant Food Properties, owners of 14 shopping centers and 90 unimproved acres of land in the Washington area. Saul would issue 1.2 million shares (vs. 3.57 million outstanding at June 30) in payment. Closing of the transaction is expected this fall. Saul earnings are strongly up for the nine months through June, at $0.94/sh. vs. $0.78. The June quarter was up 43%, from $0.23 to $0.33, and the September quarter should push the year to the $1.30-$1.35 range, vs. $1.07 last year. As a hybrid trust with about 24.5% of assets in real property, Saul also gets modest depreciation cash flow from depreciation, which amounted to about $0.085 per share in the nine months through June. The trust is well managed and the GFP acquisition should be beneficial.

? No

PORTFOLIO I
LONG TERM, INFLATION PROTECTION

Sh.	Issue-Ann.	Div.	Orig. price	Mkt. 9/7	Mkt. Val.
800	Gen.Growth	-0.80	$23.13	26.00	20,800
400	US Lsg. RE	-1.08	22.13	21.25	8,500
700	Penn. REIT	-0.85	12.50	11.38	8,750
750	Rlty.Inc.Tr	-1.20	17.13	16.00X	12,000
600	Saul(B.F.)	-1.28	19.75	21.00	12,600
400	Wash. REIT	-0.96	12.63	11.00	4,400
600	GREIT Rlty	-1.60	18.25	18.75	11,250
200	BankAm.Rlt.	-2.20	28.75	27.50	5,500
700	Mob.Hm.Com.	-0.47	9.75	8.25	5,775
300	Cabot C&F	---1.60	22.00	25.88	7,764
	Mkt. value				$97,339

Cash, beginning of month	$ 4,615
Dividends received	225
New purchases-none	---
Cash, end of month	$ 4,840
Net asset value	102,179
Net change in month	+ 8,091
% change	+ 8.6%

? No

PORTFOLIO II
INTERMEDIATE TERM, AGGRESSIVE

Sh.	Issue-Ann.	Div.	Orig. price	Mkt. 9/7	Mkt. Val.
700	Alison Mtg.	-2.28	$21.00	25.13X	14,700
400	Assoc.Mtg.	-2.40	29.38	27.88	11,152
300	Cont. Ill.	-2.48	32.12	38.00	11,400
450	Larwin MI	-2.36	24.15	29.75X	13,388
200	Guard. MI	-3.04	33.50	42.38	8,476
300	Grt.Amer.M	-2.04	26.63	31.63X	9,489
200	First Mtg.	-2.24	32.38	29.25X	5,850
200	No.Amer.M	-2.20	28.00	31.13	6,226
100	Am.Cent.	-2.32	26.00	27.00	2,700
400	Fidelity M	-2.00	20.00	21.50X	8,600
200	Cameron-Br.	-2.44	29.50	33.88	6,776
300	Sutro Mtg.	-1.60	19.38	23.00	6,900
100	Cont. Ill.	-2.48	33.38	38.00	3,800
			Mkt. value		$109,457

Cash beginning of month	$ 1,111
Dividends received	1,028
New purchases-none	---
Cash, end of month	$ 2,139
Net asset value	111,596
Net change in month	+10,217
% change	+10.1%

Fidelity Mortgage Investors reported a $235,740 gain (or $0.11/share primary earnings) from disposition of land acquired through foreclosure from Great Southwest Corp. Great Southwest Corp. and its subsidiaries have relinquished all claim to property on which Fidelity has investments. The trust is joining with three others (Midland, Palomar, Cameron-Brown) in a proposed settlement in which the trustee for Four Seasons Nursing Centers would resume interest payments at 8.5% on $8.0 million of loans held by the trusts, including $1.77 million held by Fidelity.

NEW TRUST OFFERINGS SMALLER AND FEWER

New trusts were smaller and slower in coming in recent months. Perhaps specialty is the best descriptive word for the latest additions. The newcomers:

Name	Date	Shares (000)	Price	Equity ($000)
Property Capital	7/14	750	21	15,750
Hamilton Invest. Tr.	7/22	1,250	20a	25,000
Hospital Investors	8/17	1,250	20a	25,000
Arlen Property Inv.	9/3	1,000	16½	16,500

a-With one warrant to purchase one share at $20.

Property Capital was the first private trust to go public. Emphasis is on long-term investments in the form of land leasebacks or mortgages. John Cervieri Jr. is the managing trustee. Address: Three Center Plaza, Boston, Mass. 02108

Hamilton Investment Trust will emphasize intermediate and long-term loans. Sponsors are Jersey Mortgage Co. and the Food Fair store and property complex. Carton Stallard is president of the adviser. The adviser's address: 430 Westfield Ave., Elizabeth, N. J. 07207.

Hospital Investors primarily invests in long-term loans on proprietary hospitals and other medical facilities and seeks a fixed percentage of the gross. Sponsors are Charter Medical and Fickling & Walker (real estate and mortgage banking). Jerome Nowak is president of the manager. Address: 230 Peachtree St. N.E., Atlanta, Ga. 30303.

Arlen Property Investors was established by Arlen Realty & Development to acquire some of that firm's equity interests in shopping centers and commercial units. Arlen Realty owns the Korvettes and Spartan department stores. Marshall Rose is president of the management. Address: 84 State St., Boston, Mass. 02110.

NEW OFFERINGS BY EXISTING TRUSTS

American Century Mortgage Investors on July 7 sold $22 million in 6 3/4 debentures convertible at $28 with 506,000 warrants attached to buy one share each at $23. The previous equity base was $27.5 million.

First Mortgage Investors on July 1, sold $25 million in straight 8¼% debentures (six years due in 1977).

First Pennsylvania Mortgage Trust on August 19 sold $30 million in 6 3/4 debentures convertible at $26 with 540,000 series B warrants to buy one half share each at $28.25. The previous equity base was $35.2 million.

Guardian Mortgage Investors on July 21 sold $20 million in 6 3/4% debentures with 900,000 warrants to purchase one share each at $37. The previous equity base was $45 million. The debentures may be used at face value toward exercise of the warrants. The debentures and warrants will therefore trade as something of a package with regard to the value of both relative to the market price of the shares. The final result will be a smaller addition to the equity base and number of shares than if the offering had consisted of both converts and warrants.

Written as of noon September 9.